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Taxpayer =
Parent Company
X% =
Sub-Account A =
Y% =

Dear :

This letter is in response to the letter submitted by your authorized representative requesting several rulings concerning the application of certain provisions of the Internal Revenue Code (the "Code") to a deferred annuity contract.

FACTS

The Taxpayer is a life insurance company within the meaning of § 816(a) of the Code, joins in filing a consolidated federal income tax return with Parent Company on a calendar year basis, and reports its income on an accrual method of accounting.

The Taxpayer intends to issue a non-qualified deferred annuity contract (the "Contract"). The Contract provides the right to receive life contingent payments ("Income Benefit Payments") that are similar to guaranteed lifetime withdrawal benefits. The Income Benefit Payments are triggered upon the depletion of an account value (the "Contractual Account Value") by withdrawals taken within prescribed annual limits, poor investment performance, or the combined effect thereof. The Contractual Account Value is the sum of (1) the value of a fixed account (the "Fixed Account") and (2) the value of a separate account (the "Separate Account"). The Fixed Account value (the "Fixed Account Value") is credited with interest and is supported solely by the Taxpayer's general asset account. The Separate Account value (the "Separate Account Value") equals the market value of certain mutual funds the Taxpayer holds in a separate account.

Prior to the triggering of the Income Benefit Payments, the policyholder may apply the Contractual Account Value (plus any additional premiums) to an annuity payment option under the Contract. The annuity payment options are life-contingent or period certain annuity payments ("Annuity Payments").

Form and Regulatory Treatment

The Contract is an individual flexible premium deferred annuity contract. The Contract will be treated as a variable annuity contract under the laws of each state in which it is issued, and will satisfy the nonforfeiture laws applicable to the Contract. The Contract will not be part of any eligible retirement plan within the meaning of § 402(c)(8)(B). Pursuant to the Securities Act of 1933, the Taxpayer will register the Contract as a security with the Securities and Exchange Commission ("SEC").

Ownership and Contributions

The policyholder will be the sole owner and annuitant of the Contract. All benefits under the Contract will be paid to the policyholder while he is alive, unless he directs the Taxpayer otherwise.

The Contract will allow flexible premiums ("Contributions"), subject to specified minimum and maximum contributions. Contributions may be made in cash or in kind, as described in more detail below. To facilitate in-kind Contributions to the Contract (and in-kind withdrawals from the Contract), the Contract will require the policyholder to maintain a brokerage account with a financial institution that the Taxpayer approves (the "Policyholder's Account").

The Fixed Account

A portion of each Contribution must be allocated to the Fixed Account. The required allocation will be specified in the Contract as a percentage of each Contribution and will not change after issuance. This requirement will continue until the Contract terminates, unless the Contract specifies a date on which the Fixed Account terminates ("Fixed Account Termination Date").

The Contract will not permit the policyholder to reallocate (transfer) any Fixed Account Value to the Separate Account. If, however, the Contract specifies a Fixed Account Termination Date, on that date all amounts in the Fixed Account Value will be automatically reallocated to the Separate Account pro rata based on the then-existing allocations to the Separate Account under the Contract.

Allocations to the Fixed Account will be made in cash only. Thus, if the policyholder makes a Contribution in kind by transferring mutual fund shares to the Taxpayer, the Taxpayer will sell or redeem a portion of those shares and credit the Fixed Account

Value with an amount equal to the cash proceeds. Likewise, all withdrawals from the Fixed Account will be made in cash.

The Taxpayer will hold assets supporting the Fixed Account Value in its General Account. The Taxpayer will credit the Fixed Account Value with interest at a guaranteed minimum rate or such higher rate as the Taxpayer may declare from time to time.

The Separate Account

To the extent the Contract does not require Contributions to be allocated to the Fixed Account, they will be allocated among the various Separate Account investment options pursuant to the terms of the Contract and the policyholder's instructions. If the policyholder makes a Contribution in cash, the Issuer will purchase shares of the mutual fund that correspond to the Separate Account investment options under the Contract, as described below. If the policyholder already owns shares of a mutual fund that correspond to a Separate Account investment option under the Contract, the policyholder may make a Contribution by transferring legal ownership of those shares to the Taxpayer in lieu of cash.

Each Separate Account investment option under the Contract will correspond to a sub-account of the Separate Account. Each sub-account will correspond to a mutual fund that is identified in the prospectus or other materials accompanying the Contract. Shares of the mutual funds will be available for direct purchase by the general public, including the policyholder, without having to purchase a Contract (hereinafter, "Public Mutual Funds"). The Taxpayer will hold legal title to the Public Mutual Funds in each sub-account of the Separate Account. Any dividends received with respect to the Public Mutual Funds will be automatically reinvested in the same Public Mutual Funds, and the value of the Public Mutual Funds will flow through directly to the Separate Account Value under the Contract. The Separate Account is registered with the SEC as a unit investment trust under the Investment Company Act of 1940.

The Contract will permit the policyholder to allocate and reallocate the Separate Account Value among the Public Mutual Funds within the Separate Account, subject to certain "Investment Guidelines." The Investment Guidelines are as follows:

1. Prescribed Menu of Public Mutual Funds. Only the Public Mutual Funds that the Taxpayer identifies in the prospectus or similar materials will be available as Separate Account investment options under the Contract, and the Taxpayer will reserve the right to add, remove, or replace Public Mutual Funds as investment options under the Contract.
2. Asset Class Concentration Limits. The Taxpayer will impose allocation limits based on asset classes. For example, the Taxpayer may not allow the policyholder to allocate more than X% of policyholder's Separate Account Value to Public Mutual Funds that fall within the international

equity asset class. The Taxpayer also may require that allocations among Public Mutual Funds be rebalanced when market value fluctuations cause the allocations across asset classes to deviate from the prescribed parameters.

3. Mandatory Allocations to Sub-Account A. As discussed in more detail below, the Taxpayer will require that a portion of the Separate Account Value be allocated to Sub-Account A in certain circumstances.

Sub-Account A is a sub-account of the Separate Account. Sub-Account A will invest in shares of a public mutual fund that is identified in the prospectus or other materials accompanying the Contract. The public mutual fund in which the Sub-Account A invests will follow a bond, fixed income, or similarly conservative investment strategy.

The Contract will allow the policyholder to allocate Separate Account Values to and from Sub-Account A in the same manner as other Separate Account investment options under the Contract, but in some circumstances the Taxpayer may require that a certain portion of the Separate Account Value be allocated to Sub-Account A. Based on a formula specified in the Contract, the Taxpayer may require part of the Separate Account Value to be reallocated to Sub-Account A. Similarly, the formula may require that Sub-Account A allocations be transferred back to the other Separate Account investment options the policyholder has chosen.

Withdrawals Prior to Annuitization

Prior to the date that Income Benefit Payments or Annuity Payments commence, the policyholder will have the right to take withdrawals from the Contractual Account Value. The policyholder may, but is not required to, withdraw a certain amount per Contract year. This amount is the "Guaranteed Amount" and is calculated at the time of the first withdrawal. The initial Guaranteed Amount equals the "Applicable Percentage" multiplied by the "Covered Contract Value." The Applicable Percentage is specified in the Contract and the Taxpayer expects it to be a percentage up to Y%, depending on the policyholder's age on the date of the first withdrawal. The Covered Contract Value is generally the Contractual Account Value on the date of the first withdrawal, subject to stated maximum values. The Contract also may include a "roll-up" feature under which the Covered Contract Value will grow by no less than a guaranteed minimum rate if no withdrawals are taken. In addition to these withdrawals, the policyholder has the option to take one withdrawal, subject to certain limitations specified in the Contract, prior to withdrawing the Guaranteed Amount.

Such withdrawals will be taken pro rata from the Fixed Account Value and the Separate Account Value. All withdrawals from the Fixed Account Value will be made in cash. With respect to the portion of a withdrawal that is allocable to the Separate Account Value, the withdrawal will be taken pro rata from the Separate Account investment options, including Sub-Account A (whether amounts were transferred there voluntarily or

formulaically). The policyholder may choose to receive withdrawals from the Separate Account in kind or in cash. If the withdrawal is in cash, the Taxpayer will liquidate shares of the relevant public mutual fund(s) and forward the proceeds to the policyholder. If the withdrawal is in-kind, the Taxpayer (or the Separate Account) will transfer to the policyholder legal ownership of the shares of the relevant public mutual fund(s).

Income Benefit Payments

If the Contractual Account Value is reduced to zero by withdrawals taken within prescribed annual limits, poor investment performance, or the combined effect thereof, the Contract will begin paying Income Benefit Payments equal to the Guaranteed Amount for the remainder of the policyholder's life.

The initial Guaranteed Amount is subject to adjustments in the following circumstances:

1. Withdrawals: Any withdrawal or portion thereof that exceeds the Guaranteed Amount in any Contract year (an "Excess Withdrawal") will reduce the Guaranteed Amount available in future years in the same proportion that the excess reduces the Contractual Account Value. (The Guaranteed Amount is not increased if the policyholder withdraws less than the Guaranteed Amount during a Contract year.)
2. Contributions: Contributions to the Contract after the first withdrawal is taken will increase the Guaranteed Amount by the product of the Contribution multiplied by the Applicable Percentage on the first withdrawal date. No Contributions are permitted after Income Benefit Payments begin.
3. Step-up increases: The Guaranteed Amount may be eligible to be increased, on each Contract anniversary after the first withdrawal. The increase is equal to the Covered Contract Value multiplied by the Applicable Percentage as of that anniversary date to determine the Guaranteed Amount for that Contract year.

If the Income Benefit Payments are triggered, the Taxpayer will make fixed periodic payments (e.g., annually) equal to the Guaranteed Amount for the policyholder's life.¹ In the first year Income Benefit Payments are made, they will equal the excess of the current Guaranteed Amount over the sum of any withdrawals already taken during that

¹ The Contract also allows the policyholder to make an election at issuance pursuant to which Income Benefit Payments would be payable for the joint lives of the policyholder and the policyholder's spouse if the policyholder's spouse at the time of purchase is alive and remains married to the policyholder when Income Benefit Payments commence.

year. Thereafter, the Income Benefit Payment will equal the Guaranteed Amount applicable on the date the Contractual Account Value was reduced to zero. If the Income Benefit Payments do not exceed a stated minimum, the Taxpayer may commute them to a lump sum.

Annuity Payments

Prior to Income Benefit Payments commencing, the Contract will permit the policyholder to apply the Contractual Account Value to one of several payment options to generate a series of fixed Annuity Payments. In such case, the Taxpayer will liquidate the public mutual fund shares comprising the Separate Account Value and apply the cash proceeds, plus any Fixed Account Value, to the selected annuity option. Once the Annuity Payments begin, the Contractual Account Value will be zero.

The Annuity Payments will commence on the date specified in the Contract, or on an earlier date the policyholder selects (subject to an initial waiting period). The policyholder can choose Annuity Payments that will continue at least annually (1) for his life, (2) for his life with a period certain not exceeding his life expectancy, (3) a period certain not exceeding his life expectancy, or (4) in accordance with any other Annuity Payment option the Taxpayer makes available. The policyholder cannot change the selection after Annuity Payments commence. The Annuity Payments for life are equal to the Guaranteed Amount under the Income Benefit. The Taxpayer calculates the annuity payment for life with a guaranteed period based on the policyholder's age, gender, and a table of guaranteed permanent annuity purchase rates set forth in the Contract (or more favorable annuity purchase rates that the Taxpayer makes available).

Policyholder Surrenders and Distributions Upon Policyholder's Death

If the policyholder surrenders the Contract or dies before the Income Benefits Payments or Annuity Payments commence, the Contractual Account Value will be disbursed to the policyholder or the policyholder's estate.

If Income Benefit Payments have begun prior to the policyholder's death, no further payments will be made and the Contract will terminate upon the Issuer's receipt of due proof of the policyholder's death. If Annuity Payments have begun prior to the policyholder's death, they will continue to the extent provided in the Annuity Payment option, e.g., for any remaining period certain. The Contract will include provisions requiring that all distributions after the policyholder's death be paid within the timeframes that § 72(s) prescribes.

Contract Fees and Charges

Certain fees and charges (collectively, “Contract Charges”) are payable to the Taxpayer under the terms of the Contract, as follows:²

1. Charges that compensate the Taxpayer for its expenses in issuing and administering the Contract, including its assumption of the risks that the Taxpayer will become obligated to make Income Benefit Payments or Annuity Payments for the policyholder’s entire life. These Contract Charges are payable on a quarterly or other periodic basis at a rate specified in the Contract multiplied by the greater of the Covered Contract Value or the Contractual Account Value. The policyholder may elect to pay these charges in one of two ways:
 - a. The policyholder may elect to pay them directly.
 - b. Alternatively, the policyholder may elect to have these charges deducted pro rata from the Separate Account investment options to which he voluntarily allocated his Separate Account Value. The charges will not be deducted from the Fixed Account or from any amounts in Sub-Account A that are attributable to mandatory formulaic allocations thereto. When Contract Charges are debited against the Separate Account Value, the Taxpayer will liquidate shares of Public Mutual Funds within the Separate Account and transfer the cash proceeds to its General Account.
2. A surrender charge if the policyholder surrenders the Contract within a specified number of years after issuance. The surrender charge is calculated as a percentage of the Contractual Account Value. This charge will be debited against the Contractual Account Value pro rata based on the allocations to the Fixed Account Value and the Separate Account Value.
3. Any premium taxes or similar taxes that are imposed against the policyholder and that the Contract permits the Taxpayer to pass through to the policyholder. These taxes will be debited against the Contractual Account Value pro rata based on the allocations to the Fixed Account Value and the Separate Account Value.

² The Taxpayer represents that no part of the Contract Charges compensate the Taxpayer for any investment advisory, management, or allocation services with respect to the investments made in the Separate Account.

Termination

The Contract will terminate upon the first of the following events to occur:

1. The policyholder surrenders the Contract prior to Annuity Payments or Income Benefit Payments commencing;
2. The Taxpayer receives proof of the policyholder's death prior to Annuity Payments or Income Benefit Payments commencing;
3. The policyholder dies after Income Benefit Payments have commenced;
4. Annuity Payments cease pursuant to the terms of the selected payment option, e.g., the policyholder dies and/or the chosen period certain expires;
5. The policyholder takes an Excess Withdrawal that exhausts his Contractual Account Value;
6. The policyholder fails to pay certain Contract Charges within the required timeframe;
7. The policyholder closes the Policyholder's Account; or
8. Annuity Payments or Income Benefit Payments are set to commence but would be payable in amounts that are less than minimums stated in the Contract, in which case the Taxpayer will commute the payments to a single lump sum payment.

ADDITIONAL REPRESENTATIONS

The Taxpayer makes the following representations in support of the rulings requested herein:

1. The Contract will comply with § 72(s).
2. The Contract will be treated as an annuity contract under the state insurance laws and regulations of any state in which it is issued.
3. The marketing materials for the Contract will not include any explicit or implicit representations that changes in the fair market value of the Contractual Account Value, including the Separate Account Value and any Public Mutual Funds that comprise that value, are expected to approximate, directly or inversely, changes in the fair market value of the Contract.

4. The Income Benefit protects primarily against longevity risk rather than market risk.
5. If Annuity Payments commence over a period certain without a life contingency, the period certain will be longer than one year.
6. Based on Rev. Rul. 81-225, 1981-2 C.B. 12, the Taxpayer will be a nominee of the policyholder with respect to amounts the Separate Account receives from the relevant Public Mutual Funds on the policyholder's behalf. As a nominee, the Taxpayer will have, and intends to comply with, obligations to report such amounts to the Service and the policyholder.

REQUESTED RULINGS

1. For federal income tax purposes, the policyholder, and not the Taxpayer, will be treated as owning the Public Mutual Fund shares that comprise the Separate Account Value under the Contract, and as result of this conclusion:
 - a. Each year, the policyholder should reflect in his gross income any gains, income, or losses with respect to the Public Mutual Fund shares, with the amount and tax character of such items being the same as if he held the shares directly. For this purpose, any redemption of Public Mutual Fund shares to (1) make a cash payment to the policyholder or his designee, (2) reallocate the Separate Account Value among the Separate Account investment options, (3) pay Contract Charges, or (4) be applied to generate Annuity Payments will incur the same tax consequences to the policyholder as if he redeemed the Public Mutual Fund shares directly and received the resulting cash.
 - b. A transfer of legal ownership of Public Mutual Fund shares between the Taxpayer (or the Separate Account) and the policyholder, whether as a Contribution to or a withdrawal from the Contract, will not be a taxable event.
2. For federal income tax purposes, the Contract will constitute an annuity contract taxable under § 72, except for the portion of the Contract comprised of the Separate Account Value where the policyholder is treated as the owner of the Public Mutual Fund shares and taxable under § 61.
3. For purposes of § 72, the Contract's "cash value" or "cash surrender value" will be comprised solely of the Fixed Account Value and not the Separate Account Value, and as a result of this conclusion:
 - a. Any withdrawal from the Contract that is allocable to the Fixed Account Value will be taxable under § 72(e); and

- b. Any Contract Charges that are deducted from the Fixed Account Value will be treated as internal charges under the Contract that do not give rise to a taxable distribution.
- 4. Any Contributions that are allocated to the Fixed Account, any Separate Account Value that is applied to generate Annuity Payments, and any Contract Charges that are paid from the Separate Account Value or that the policyholder pays directly from his checking or similar after-tax account will give rise to “investment in the contract” within the meaning of §§ 72(c)(1) and 72(e)(6).
- 5. The Income Benefit Payments and Annuity Payments will be treated as “amounts received as an annuity” using an “exclusion ratio” under § 72(b), except that the initial Income Benefit Payment will be treated as an “amount not received as an annuity” that is taxable under § 72(e) if such payment is not made within the same interval as the succeeding Income Benefit Payments or is not made on or after the annuity starting date as defined in § 1.72-4(b).

LAW AND ANALYSIS

Requested Ruling #1

In general, the holder of legal title is the owner of the property and is taxed on the income derived from the property. However, if a person other than the holder of legal title possesses the “benefits and burdens” of ownership, that person is attributed ownership of property for tax purposes. See, e.g., Frank Lyon Company v. United States, 435 U.S. 561 (1978); Helvering v. Clifford, 309 U.S. 331 (1940). The Supreme Court summarized this principle in Corliss v. Bowers, 381 U.S. 376, 378 (1930), stating that “taxation is not so much concerned with the refinements of title as it is with actual command over the property taxed - the actual benefit for which the tax is paid.”

The Service applied these general tax ownership principles in a series of “investor control” rulings. Rev. Rul. 77-85, 1977-1 C.B. 12, Rev. Rul. 80-274, 1980-2 C.B. 27, Rev. Rul. 81-225, Rev. Rul. 82-54, 1982-1 C.B. 11, Rev. Rul. 2003-91, 2003-2 C.B. 347, and Rev. Rul. 2003-92, 2003-2 C.B. 350. The rulings stand for the proposition that contract holders possessing control over the investment of the separate account assets (in addition to the other benefits and burdens of contract ownership) are the owners of separate account assets for federal income tax purposes even if the insurance company retains possession of and legal title to those assets. See also, Christoffersen v. United States, 749 F.2d 513 (8th Cir. 1984).

In Rev. Rul. 81-225, the Service described four situations in which the contract holder is considered the owner of mutual fund shares held by insurance companies in connection with annuity contracts and one situation in which the insurance company is the owner of the mutual fund shares for federal income tax purposes. In the four situations in which the contract holder is considered the owner of the mutual fund shares, the shares are

available for purchase other than through the purchase of an annuity contract. In those situations, the Service concluded that the contract holder had investment control over the mutual fund shares and that the contract holder's position in each situation was substantially identical to what it would have been had the mutual fund shares been purchased directly by the contract holders. Conversely, in the situation in which the mutual fund shares were only available through the purchase of an annuity contract, the insurance company was the owner for federal income tax purposes.

In Rev. Rul. 2003-92, the purchasers of variable annuity and variable life insurance contracts were able to allocate their premiums among ten different sub-accounts. Each sub-account invested in a partnership. In the factual scenario in which the partnership interests were available other than through the purchase of a variable annuity or life insurance contract, the Service concluded that the contract holders were the owners of the interests in the partnerships. In contrast, if the partnership interests were only available through the purchase of a variable annuity or life insurance contract, the Service concluded that the insurance company was the owner of the interests in the partnerships.

Here, each sub-account corresponds to a Public Mutual Fund that is identified in the prospectus or other materials accompanying the Contract. The Taxpayer will hold legal title to the Public Mutual Funds in each sub-account of the Separate Account. However, shares of the Public Mutual Funds will be available for direct purchase by the general public, including the policyholder, without having to purchase a Contract. Accordingly, for federal income tax purposes, the policyholder, and not the Taxpayer, will be treated as owning the Public Mutual Fund shares that comprise the Separate Account Value under the Contract. Thus, the Taxpayer should not reflect in the computation of its taxable income any gains, income, or losses with respect to the Public Mutual Fund shares.

- a. Each year, the policyholder should reflect in his gross income any gains, income, or losses with respect to the Public Mutual Fund shares, with the amount and tax character of such items being the same as if he held the shares directly. For this purpose, any redemption of Public Mutual Fund shares to (1) make a cash payment to the policyholder or his designee, (2) reallocate the Separate Account Value among the Separate Account investment options, (3) pay Contract Charges, or (4) be applied to generate Annuity Payments will incur the same tax consequences to the policyholder as if he redeemed the Public Mutual Fund shares directly and received the resulting cash.*

As a result of the policyholder being treated as owning the Public Mutual Fund shares, each year, the policyholder should reflect in his gross income any gains, income, or losses with respect to the Public Mutual Fund shares, with the amount and tax character of such items being the same as if he held the shares directly.

- b. A transfer of legal ownership of Public Mutual Fund shares between the Taxpayer (or the Separate Account) and the policyholder, whether as a Contribution to or a withdrawal from the Contract, will not be a taxable event.*

Similarly, as a result of the policyholder being treated as owning the Public Mutual Fund shares, a transfer of legal ownership of Public Mutual Fund shares between the Taxpayer (or the Separate Account) and the policyholder, whether as a Contribution to or a withdrawal from the Contract, will not be a taxable event.

Requested Ruling #2

Section 72(a) provides that, except as otherwise provided, gross income includes any amount received as an annuity (whether for a period certain or during one or more lives) under an annuity, endowment, or life insurance contract. The Code does not otherwise define an annuity contract or “any amount received as an annuity.”

Section 1.72-2(a)(1) of the Income Tax Regulations provides that the contracts under which amounts paid will be subject to the provisions of § 72 include contracts which are considered to be life insurance, endowment, and annuity contracts in accordance with the customary practice of life insurance companies. Under §§ 1.72-1(b) and (c), as a general matter “amounts received as an annuity” are amounts which are payable at regular intervals over a period of more than one full year from the date on which they are deemed to begin, provided the total of the amounts so payable or the period for which they are to be paid can be determined as of that date, a proportionate part of which is considered to represent a return of premiums or other consideration paid.

Under § 1.72-2(b), amounts are considered as “amounts received as an annuity” only if all of the following tests are met: (1) the amounts are received on or after the annuity starting date, (2) the amounts are payable in periodic installments at regular intervals over a period of more than one full year from the annuity starting date, and (3) the amounts payable must be determinable either directly from the terms of the contract or indirectly from the use of either mortality tables or compound interest computations, or both (if the contract is a variable contract, § 1.72-2(b)(3) provides an alternative formulation of this requirement). Under § 1.72-4(b)(1), the annuity starting date is the first day of the first period for which an amount is received as an annuity; the first day of the first period for which an amount is received as an annuity shall be the later of (1) the date upon which the obligations under the contract became fixed or (2) the first day of the period which ends on the date of the first annuity payment.

Explaining imposition of an “income-out-first” rule under §72(e) for withdrawals prior to the annuity starting date, the Senate report described a commercial annuity as

a promise by a life insurance company to pay the beneficiary
a given sum for a specified period, which period may
terminate at death. Annuity contracts permit the systematic

liquidation of an amount consisting of principal (the policyholder's investment in the contract) and income.... An individual may purchase an annuity by payment of a single premium or by making periodic payments. A deferred annuity contract may, at the election of the individual, be surrendered before annuity payments begin, in exchange for the cash value of the contract.... The committee believes that the use of deferred annuity contracts to meet long-term investment goals, such as income security, is still a worthy ideal.

S. Rep. No. 97-494 at 349-50 (1982)(footnote omitted).

In Life & Health Insurance, Black and Skipper state that “[i]n the broadest sense, an annuity is simply a series of periodic payments” and while “[l]ife insurance has as its principal mission the creation of a fund [, t]he annuity, on the contrary, has as its basic function the systematic liquidation of a fund.” Kenneth Black, Jr. and Harold D. Skipper, Jr., Life & Health Insurance, 161-62 (13th ed. 2000).

Elsewhere an annuity has been described as “a right to receive fixed, periodic payments, for a specified period of time” and an annuity contract as

a contract under which, in exchange for the payment of a premium or premiums, the recipient thereof is bound to make future payments, typically at regular intervals, in amounts, to payees, and conditions specified in the parties' agreement. The determining characteristic of an annuity is that the annuitant has an interest only in the periodic payments and not in any principal fund or source from which they may be derived. Although an individual who purchases an annuity remains the technical owner of the asset, he or she does not retain total control over that asset and does not have unfettered access to the full amount of his or her own “property.”

4 Am. Jur. 2d Annuities, § 1 (2008). Moreover, “[t]he purchaser of an annuity surrenders all rights to the money paid, and therefore installment payments of a debt, or payments of interest on a debt, do not constitute an annuity.” Id. at § 2.

Here, except for the portion of the Contract comprised of the Separate Account Value where the policyholder is treated as the owner of the Public Mutual Fund shares and taxable under § 61, the Contract possesses the essential attributes of an annuity. The Contract and the Income Benefits Payments meet the requirements of §§ 1.72-1(b) and (c), 1.72-2(a)(1) and (b)(3), and 1.72-4(b)(1) as annuity contracts and annuity payments, respectively. Additionally, the Contract is purchased “by making periodic payments” of

premium for “a promise by a life insurance company to pay the beneficiary a given sum for a specified period, which period may terminate at death,” and is “used to provide long-term income security.” S. Rep. No. 97-464 at 349. Moreover, it has “the determining characteristic ... that the annuitant has an interest only in the periodic payments and not in any principal fund or source from which they may be derived.” 4 Am. Jur. 2d Annuities, §1. The policyholder will have “surrender[ed] all rights to the money paid,” thereby distinguishing the Contract from “installment payments of a debt, or payments of interest on a debt,” which are not annuities. Id.

Accordingly, the Contract will constitute an annuity contract taxable under § 72, except for the portion of the Contract comprised of the Separate Account Value where the policyholder is treated as the owner of the Public Mutual Fund shares and taxable under § 61.

Requested Ruling #3

Section 72(e) governs the federal income tax treatment of amounts received under annuity, endowment, or life insurance contract that are not received as an annuity. In general under § 72(e)(2), a non-annuity amount that is received on or after the annuity starting date is included in gross income. If a non-annuity amount is received before the annuity starting date, it is included in gross income to the extent allocable to income on the contract, but not to the extent allocable to investment in the contract.

Section 72(e)(3)(A) specifies that any amount to which this subsection applies is treated as allocable to income on the contract to the extent that such amount does not exceed the excess (if any) of the cash value of the contract (determined without regard to any surrender charge) immediately before the amount is received, over the investment in the contract at such time.

Section 72 does not define the terms “cash value” or “cash surrender value” with regard to an annuity contract. The common definition of “cash surrender value” is “the amount made available, contractually, to a withdrawing policyowner who is terminating his or her protection.” Black, supra, at 46 (13th ed. 2000); see also John H. Magee, Life Insurance 599 (3d ed. 1958) (“The cash value represents the amount available to the policyholder upon the surrender of the life insurance contract.”).

Rev. Rul. 77-85, 1977-1 C.B. 12, addressed an arrangement involving an investment annuity policy. In the ruling,

[t]he policyholder may not receive any amount directly from the account and may not receive a distribution of assets in kind. At any time prior to the annuity starting date, however, the policyholder may make a full or partial surrender of the policy to the insurance company. If such a surrender is made, the custodian is directed by the agreement to sell all

or part of the assets as appropriate and to pay over the necessary proceeds to the insurance company. The insurance company in turn will make the full or partial cash surrender payment to the policyholder in an amount equal to the proceeds received by the insurance company from the account, less any cash surrender charges.

The ruling does not address whether the underlying account created any “cash value” or “cash surrender value” for the investment annuity policy. Nonetheless, the ruling illustrates the connection between an account owned by the policyholder (here, the Separate Account) and the annuity contract (here, the Contract). The policyholder is the owner of the Separate Account assets for federal income tax purposes. Accordingly, those shares cannot also comprise part of the Contract’s “cash value” or “cash surrender value” for purposes of § 72.

On the other hand, the Fixed Account Value is part of the Contract for federal income tax purposes. Accordingly, it is proper to treat the Fixed Account Value as comprising the Contract’s “cash value” or “cash surrender value” for purposes of § 72.

- a. Any withdrawal from the Contract that is allocable to the Fixed Account Value will be taxable under § 72(e).*

Based on the conclusion that the Fixed Account Value comprises the Contract’s “cash value” or “cash surrender value,” any withdrawals from the Contract, to the extent they are allocable to the Fixed Account Value under the terms of the Contract, will be taxable to the policyholder under § 72(e).

- b. Any Contract Charges that are deducted from the Fixed Account Value will be treated as internal charges under the Contract that do not give rise to a taxable distribution.*

Also based on the conclusion that the Fixed Account Value comprises the Contract’s “cash value” or “cash surrender value,” the Contract Charges that are deducted from the Fixed Account Value will be treated as internal charges against the Contract’s cash value for purposes of § 72 that do not give rise to a taxable distribution.

Requested Ruling #4

Section 72(c)(1) provides that, for purposes of the exclusion ratio under § 72(b), the “investment in the contract” as of the annuity starting date is the aggregate amount of premiums or other consideration paid for the contract, minus the aggregate amount received under the contract before such date, to the extent that such amount was excludable from gross income. Under § 72(c)(2), this amount is then reduced by the value of the refund feature, if any.

Section 72(e)(6) provides that for purposes of § 72(e), the “investment in the contract” as of any date is the aggregate amount of premiums or other consideration paid for the contract before such date, minus the aggregate amount received under the contract before such date, to the extent that such amount was excludable from gross income.

As mentioned, Rev. Rul. 77-85 addressed an investment annuity contract. That ruling held that the issuer should include in its premium income only the premiums and charges paid each year.

Accordingly, any Contributions that are allocated to the Fixed Account, any Separate Account Value that is applied to generate Annuity Payments, and any Contract Charges that are paid from the Separate Account Value or that the Individual pays directly from his checking or similar after-tax account will give rise to “investment in the contract” within the meaning of §§ 72(c)(1) and 72(e)(6).³

Requested Ruling #5

Section 72(a) provides that gross income includes any amount received as an annuity (whether for a period certain or during one or more lives) under an annuity, endowment, or life insurance contract.

Section 72(b)(1) provides that gross income does not include that part of any amount received as an annuity under an annuity, endowment, or life insurance contract which bears the same ratio to such amount as the investment in the contract (as of the annuity starting date) bears to the expected return under the contract (as of such date).

Section 72(c)(4) defines “annuity starting date” as the first day of the first period for which an amount is received as an annuity under the contract.

Section 1.72-2(b)(2) defines “amounts received as an annuity” as only those amounts that meet all of the following tests:

- a. they must be received on or after the ‘annuity starting date’ as that term is defined in § 1.72-4(b);
- b. they must be payable in periodic installments at regular intervals (whether annually, semiannually, quarterly, monthly, weekly, or otherwise) over a period of more than one full year from the annuity starting date; and

³ As explained at note 2, Taxpayer represents that no part of the Contract Charges compensate the Taxpayer for any investment advisory, management, or allocation services with respect to the investments made in the Separate Account.

- c. except as indicated in § 1.72-2(b)(3), the total of the amounts payable must be determinable at the annuity starting date either directly from the terms of the contract or indirectly by use of either mortality tables or compound interest computations, or both, in conjunction with such terms and in accordance with sound actuarial theory.

Section 1.72-4(b) defines “annuity starting date” as the first day of the first period for which an amount is received as an annuity; the first day of the first period for which an amount is received as an annuity shall be whichever of the following is the later:

- a. the date upon which the obligations under the contract became fixed, or
- b. the first day of the period (year, half-year, quarter, month, or otherwise, depending on whether payments are to be made annually, semiannually, quarterly, monthly, or otherwise) which ends on the date of the first annuity payment.

Here, once the Contractual Account Value is reduced to zero and Income Benefit Payments become payable, (1) the annuity starting date is reached; (2) the Income Benefit Payments will be payable at periodic intervals over a period of more than one full year from the annuity starting date; and (3) the total amount payable is determinable at the annuity starting date using mortality tables and sound actuarial theory. Hence, the Income Benefit Payments will be amounts received as an annuity, except that the initial Income Benefit Payment will be treated as an “amount not received as an annuity” that is taxable under § 72(e) if such payment is not made within the same interval as the succeeding Income Benefit Payments or is not made on or after the annuity starting date as defined in § 1.72-4(b).

With respect to the Annuity Payment, if the policyholder exercises the annuity option, the obligations under the Contract become fixed once the Annuity Payments begin. Specifically, the amount of the Annuity Payments will not change. The Annuity Payments will be (1) received on or after the annuity starting date; (2) will be payable at regular intervals over a period of more than one full year from the annuity starting date; and (3) the total amount payable is determinable at the annuity starting date using mortality tables and sound actuarial theory. Accordingly, the Annuity Payment will be “an amount received as an annuity.”

Either the Income Benefit Payment or the Annuity Payment⁴ will be taxable under § 72(a) as an amount received as an annuity, subject to the exclusion of the amount allocable to the investment in the contract determined under § 72(b).

⁴ The Taxpayer cannot receive both.

RULINGS

Based on the foregoing,

1. For federal income tax purposes, the policyholder, and not the Taxpayer, will be treated as owning the Public Mutual Fund shares that comprise the Separate Account Value under the Contract, and as result of this conclusion:
 - a. Each year, the policyholder should reflect in his gross income any gains, income, or losses with respect to the Public Mutual Fund shares, with the amount and tax character of such items being the same as if he held the shares directly. For this purpose, any redemption of Public Mutual Fund shares to (1) make a cash payment to the policyholder or his designee, (2) reallocate the Separate Account Value among the Separate Account investment options, (3) pay Contract Charges, or (4) be applied to generate Annuity Payments will incur the same tax consequences to the policyholder as if he redeemed the Public Mutual Fund shares directly and received the resulting cash.
 - b. A transfer of legal ownership of Public Mutual Fund shares between the Taxpayer (or the Separate Account) and the policyholder, whether as a Contribution to or a withdrawal from the Contract, will not be a taxable event.
2. For federal income tax purposes, the Contract will constitute an annuity contract taxable under § 72, except for the portion of the Contract comprised of the Separate Account Value where the policyholder is treated as the owner of the Public Mutual Fund shares and taxable under § 61.
3. For purposes of § 72, the Contract's "cash value" or "cash surrender value" will be comprised solely of the Fixed Account Value and not the Separate Account Value, and as a result of this conclusion:
 - a. Any withdrawal from the Contract that is allocable to the Fixed Account Value will be taxable under § 72(e); and
 - b. Any Contract Charges that are deducted from the Fixed Account Value will be treated as internal charges under the Contract that do not give rise to a taxable distribution.
4. Any Contributions that are allocated to the Fixed Account, any Separate Account Value that is applied to generate Annuity Payments, and any Contract Charges that are paid from the Separate Account Value or that the policyholder pays directly from his checking or similar after-tax account will give rise to "investment in the contract" within the meaning of §§ 72(c)(1) and 72(e)(6).

5. The Income Benefit Payments and Annuity Payments will be treated as “amounts received as an annuity” using an “exclusion ratio” under § 72(b), except that the initial Income Benefit Payment will be treated as an “amount not received as an annuity” that is taxable under § 72(e) if such payment is not made within the same interval as the succeeding Income Benefit Payments or is not made on or after the annuity starting date as defined in § 1.72-4(b).

CAVEATS

The rulings contained in this letter are based upon information and representations submitted by the Taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. This office has not verified any of the material submitted in support of the request for rulings and it is subject to verification upon examination.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter, including but not limited to issues under Subchapter D (§ 401-436), the computation of the exclusion ratio under § 72(b), or the application of part 1 of subchapter L (§§ 801-818).

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

John E. Glover
John E. Glover
Senior Counsel, Branch 4
(Financial Institutions & Products)